FISCAL NOTE

Bill #:	SB0512	**Title:**	General sales tax with property tax relief
Primary Sponsor:	Kitzenberg, S	**Status:**	As Amended in Senate Committee

Sponsor signature Date David Ewer, Budget Director Date

Fiscal Summary

	FY 2006 Difference	FY 2007 Difference
Expenditures:		
General Fund	$6,367,076	$1,801,588
State Special Revenue	$188,925,000	$397,535,000
Revenue:		
General Fund	$156,110,653	$155,265,116
State Special Revenue	$214,390,000	$439,423,351
Net Impact on General Fund Balance:	$149,743,577	$153,463,528

☒ Significant Local Gov. Impact
☐ Included in the Executive Budget
☒ Dedicated Revenue Form Attached
☒ Technical Concerns
☒ Significant Long-Term Impacts
☒ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

Department of Revenue:

1. This bill provides for a general retail sales tax. Low-income households are provided with a credit against individual income tax liability to offset sales taxes. The bill increases the tax rates on class 9 and class 13 property and repeals the statewide 101 mills levied for schools and the university system. It appropriates sales tax revenue for BASE school funding and existing reimbursements to local governments. It allocates sales tax revenue for various health and education purposes, and for the cost of administering the sales tax. Any remainder would go to the general fund. This bill also allocates sales tax revenue to several accounts but the corresponding expenditures are appropriated in other bills.

Property Tax - Elimination of the 101 Mills

2. This bill repeals the 95 mills levied for the state general fund and the 6 mills levied for the university account beginning January 1, 2006. Non-levy revenue associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts.
3. Most property taxes are paid in November and May of the fiscal year following assessment. However, under the provisions of 15-16-119, MCA, owners of personal property that is not liened to real property

pay property taxes 30 days after assessments are mailed. This means that instead of paying taxes in November and May of the following fiscal year, they will pay sometime before April in the current fiscal year. Therefore, there are some FY 2006 impacts associated with the bill.

4. About 38% of personal property is identified as "personal property not liened to real property". In FY 2006, the estimated taxable value associated with this property is $47,631,468. In FY 2007, total statewide taxable value is estimated to be $1,852,941,477.
5. In FY 2006, the reduction in general fund revenue from eliminating the 95 mills is estimated to be $4,524,989 ($47,631,468 x 95.0 mills); in FY2007 this revenue reduction is estimated to be $176,029,440 ($1,852,941,477 x 95.0 mills).
6. Estimated mill levy property tax loss to the university 6-mill account is $285,789 ($47,631,468 x 6 mills) in FY 2006 and $11,117,649 ($1,852,941,477 x 6 mills) in FY 2007.
7. In addition to mill levy revenue loss, non-levy revenue from federal forest payments and miscellaneous sources associated with these mills will accrue to other local government and school district accounts in proportion to the mills levied for those accounts. This is estimated to reduce revenues to the state general fund by an additional $3,755,000 in FY 2007.
8. Non-levy revenues to the 6-mill university system account are reduced by an estimated $300,000 in FY 2007.
9. Total property tax revenue *loss* to the general fund as a result of eliminating the 95 mills levied for the general fund is estimated to be **$4,524,989** for FY 2006 and **$179,784,440** ($176,029,440 + $3,755,000) for FY 2007.
10. Total property tax revenue *loss* to the 6-mill university system account is estimated at **$285,789** for FY 2006 and **$11,417,649** ($11,117,649 + $300,000) for FY 2007.

<u>Property Tax - Class 9 and Class 13 Tax Rate Increase</u>

11. Section 4 increases the tax rate on class 9 property (pipelines and non-electric generating property of electric utilities) from the current law 12% to 14.6% beginning January 1, 2006. Section 5 increases the tax rate on class 13 property (telecommunication utilities and electric generating property of electric utilities) from the current law 6% to 7.3%. Because this bill repeals the 95 state general fund mills levied for school equalization and the 6 mills levied for the university system, the 1.5 mill general fund levy for vocational schools is the only state revenue impacted by these rate increases. The increase in revenue to the general fund from the 1.5-mill levy is estimated to be **$28,642** in FY 2006 and **$28,556** FY 2007.

<u>Sales Tax</u>

12. Beginning January 1, 2006, this bill would impose a 4% sales and use tax on retail sales of tangible personal property and rentals, other than accommodations and campgrounds, which would continue to be taxed at the current law rate of 3%. The bill provides for the following exemptions: sales of real property and improvements; inputs to mining and manufacturing; property or a service for resale; purchases by tribes or governments; sales of utility services, including telecommunications services; unprepared food; prepared food that is part of a residential or health care arrangement; medicine, durable medical equipment, mobility enhancing equipment, and therapeutic and prosthetic devices; motor fuels; dividends and interest; isolated or occasional sales; agricultural inputs; agricultural sales; sale or lease of mineral interests; sales of platinum or palladium; mining inputs; minerals; reagents used in the processing of ores or petroleum; and radio and television broadcasting to the extent prohibited by federal law.
13. During the six months of FY 2006 when the sales tax would be in effect, taxable sales would be $5,209.646 million, and gross tax liability would be $208.385 million. In FY 2007, taxable sales would be $10,964.163 million, and tax liability would be $438.567 million. To control for noncompliance, it is assumed that

vendors would remit taxes equal to 95% of tax liability. This reduces collections by $10.419 million in FY 006, and by $21.928 million in FY 2007.

14. There would be approximately 19,200 businesses collecting the tax on their sales. The bill provides for a vendor allowance of 5% of sales tax collected up to a maximum of $350 a month. Vendor allowances would total $9.041 million in FY 2006, and $18.315 million in FY 2007.
15. Total gross tax liability, adjusted for noncompliance and vendor allowances, would be remitted to the state. Net sales and use tax collections, before sales tax administration costs, would be $188.925 million in FY 2006 and $398.324 million in FY 2007. Sales tax revenue would be deposited in a new sales and use tax special revenue account.

Allocation of Sales Tax Revenue

16. Under current law, reimbursements to local governments under SB 417, passed by the 1995 legislature, are withheld from county treasurer payments to the state for the statewide 40 mills levied under 20-9-360, MCA. Because this bill repeals the 40 mills levied for school equalization, section 2 of the bill amends 15-1-112(13)(a), MCA to require that these payments be made from the sales and use tax account. This has no impact on total state revenues.
17. Section 45 of the bill amends 15-68-820, MCA to provide for allocations of sales tax revenue from the state special revenue account for various purposes as shown in the following table:

Allocation of Sales Tax Revenue	FY 2006 (millions $)	FY 2007 (millions $)	FY 2008 (millions $)
Class 8 declining reimbursement to local governments (SB417)	2.823	1.934	0.976
DPHHS for Older MT Services- 4.7% FY06 / 4.35% thereafter	8.879	17.327	18.264
OCHE higher education grants- 2.23% FY06 / 2.17% thereafter	4.213	8.644	9.111
Older MT Trust fund account-2.23% FY06 / 2.17% thereafter	4.213	8.644	9.111
DPHHS Chemical Dependency-4.79% FY06 / 4.93% thereafter	9.050	19.637	20.700
General Fund for K-12 health insurance Pool 13.33% FY07 and thereafter	0.000	53.097	55.969
General Fund for Health and Medicaid Initiatives - 1.81% FY06 / 3.37% thereafter	3.420	13.424	14.150
General fund for sales tax administrative expenses 3.02% FY06 / 1.46% thereafter	5.706	5.816	6.130
Total (millions $)	**38.303**	**128.521**	**134.411**

18. This bill appropriates money from the sales tax account for schools and the SB 417 reimbursements. This fiscal note assumes that the other funds allocated in Section 45 are appropriated in other bills. Thus, the expenditures are not shown in this fiscal note.
19. After the allocations in the table above are made, any funds remaining would be transferred to county school equalization accounts and then transferred from there to the state general fund. This would be $150.622 million in FY 2006 and $269.803 million in FY 2007.

Individual Income Tax

20. Section 12 of this bill provides for a *nonrefundable* tax credit against individual income tax liability to offset sales taxes to low-income households. Eligible taxpayers are defined as single filers with adjusted gross income of $14,000 or less; and married-couple or head-of-household filers with adjusted gross income of $28,000 or less, adjusted annually for inflation.
21. In tax year 2006, single filers with adjusted gross income of $14,000 or less are forecast to have total adjusted gross income of $475,872,119; with 2% of this amount being $9,517,442. Because the credit is nonrefundable, the amount of tax credit that can be claimed by these taxpayers is limited by the amount of their actual tax liability. This reduces the amount of credit that can actually be used to reduce taxes to $3,748,863 for these taxpayers.

22. In tax year 2006 married couples and heads of households with adjusted gross income of $28,000 or less are forecast to have total adjusted gross income of $787,108,161; with 2% of this amount being $15,742,163. Because the credit is nonrefundable, the amount of tax credit that can be claimed by these taxpayers also is limited by the amount of their actual tax liability. This reduces the amount of credit that can actually be used to reduce taxes to $7,887,365 for these taxpayers.
23. The total tax credit associated with tax year 2006 liabilities is $11.636 million. This credit would be claimed when tax year 2006 tax returns are filed in the spring of 2007, *reducing* general fund revenues by $11.636 million in FY 2007.
24. In addition, eliminating the 101 state mills and mill levies associated with the BASE portion of school funding for tax year 2006 (FY 2007), will reduce deductions for property taxes. This will increase individual income taxes in FY 2007, offsetting the above reductions. These changes to property taxes are estimated to increase state income tax liabilities for full-year residents by $2.784 million in FY2007.
25. The net effect on income tax revenue in FY 2007 is $8.852 million.

Oil and Gas Production Tax

26. Section 13 of this bill amends 15-36-331, MCA to eliminate any distribution of oil and natural gas production revenue to the 6-mill university system account. This section applies to production after December 31, 2005. This will reduce revenue to the university system account by half the FY 2006 current law amount and by the entire FY 2007 current law amount, or by $859,000 in FY 2006, and by $1.735 million in FY 2007. Revenue to the state general fund will increase by $859,000 in FY 2006, and by $1.735 million in FY 2007.

Revenue Summary

27. Changes in collections to the general fund, the University System 6 mill account, and the sales tax account are shown in the following table:

Changes in Tax Collections		
	FY 2006	FY 2007
General Fund		
eliminate 95 mills	-$4,524,989	-$179,784,440
class 9 & 13 rates	$28,642	$28,556
income tax	$0	-$8,852,000
oil & gas tax	$859,000	$1,735,000
Total	-$3,637,347	-$186,872,884
University System 6 milll Account		
eliminate 6 mills	-$285,789	-$11,417,649
oil & gas tax	-$889,000	-$1,735,000
Total	-$1,174,789	-$13,152,649
Sales Tax	$188,925,000	$398,324,000
Total New Revenue	$184,112,864	$198,298,467

Revenue to the general fund and other funds includes the allocations from the sales tax account shown in Assumption 17.

Tax Administration

28. The Department of Revenue would require an additional 58 FTE in FY 2006 and 79 FTE in FY 2007 to implement this tax. Total costs, as detailed below would be $9,190,076 in FY2006 and $3,735,588 in FY 2007.
29. This bill does not change the Department of Revenue's responsibilities or costs for administering the income, property, and oil and gas taxes.

Office of Public Instruction:

30. State support for schools will continue to be provided through a general fund appropriation. SB 512 as amended does not affect the level of state support for school district general fund budgets.
31. Under current law, the state will receive federal forest payments of $2.205 million in FY 2007 as non-levy revenue. With the elimination of the state 95 mill education levies, 84% of this revenue will go to county-wide school retirement funds. The state pays guaranteed tax base aid (GTBA) to these funds, and GTBA payments will be reduced by 27% of the increase in federal forest payments. This will reduce general fund expenditures for GTBA by $0.502 million in FY 2007.
32. Sales tax revenue not allocated for other uses will be transferred to the county school equalization accounts. This is $38.302 million in FY 2006 and $129,013 million in FY 2007. The counties will then pay the same amount into the state general fund.

General Fund Revenue:

33. This bill reduces collections of taxes going to the general fund by $3,637,349 in FY 2006 and $186,872,884 in FY 2007. It makes direct transfers from the sales tax account to the general fund of $9,125,000 in FY 2006 and $72,827,000 in FY 2007. It also makes indirect transfers from the sales tax account to the general fund through the county school equalization accounts of $150,623,000 in FY 2006 and $269,311,000 in FY 2007. The total change in general fund revenue is $156,110,653 in FY 2006 and $155,265,116 in FY 2007.

Fiscal Note Request SB0512, As Amended in Senate Committee
(continued)

FISCAL IMPACT:

	FY 2006 Difference	FY 2007 Difference
FTE	58.00	79.00
Expenditures:		
Personal Services	$2,139,111	$2,923,749
Operating Expenses- FTE	$628,765	$610,039
Contract for IT modifications	$6,000,000	$0
Equipment	$422,200	$201,800
Transfers		
from General Fund to schools for GTBA	($2,823,000)	($1,934,000)
from Sales Tax Account		
SB 417 reimbursement	$2,823,000	$1,934,000
older Montanans services account	$8,879,000	$17,327,000
higher education grants account	$4,213,000	$8,644,000
older Montanans trust account	$4,213,000	$8,644,000
chemical dependency account	$9,049,000	$19,637,000
sales tax account to general fund	$9,125,000	$72,336,000
counties for school equalization	$150,623,000	$269,013,000
TOTAL	$195,292,076	$399,336,588
Funding of Expenditures:		
General Fund (01)	$6,367,076	$1,801,588
State Special Revenue (02)		
Sales Tax account	$188,925,000	$397,535,000
TOTAL	$195,292,076	$400,125,588
Revenues:		
General Fund (01)	$156,110,653	$155,265,116
State Special Revenue (02)		
University System 6 mill account	($889,000)	($13,152,649)
Sales Tax account	$188,925,000	$398,324,000
older Montanans services account	$8,879,000	$17,327,000
higher education grants account	$4,213,000	$8,644,000
older Montanans trust account	$4,213,000	$8,644,000
chemical dependency account	$9,049,000	$19,637,000
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$149,743,577	$153,463,528
State Special Revenue (02)		
University System 6 mill account	($889,000)	($13,152,649)
Sales Tax account	$0	$0
older Montanans services account	$8,879,000	$17,327,000
higher education grants account	$4,213,000	$8,644,000
older Montanans trust account	$4,213,000	$8,644,000
chemical dependency account	$9,049,000	$19,637,000

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
Local governments and school districts will receive an additional $3.755 million in non-levy revenues in FY 2007 and thereafter, from repealing the 95 mills levied for state general fund purposes.

Section 4 increases the tax rate on class 9 property (pipelines and non-electric generating property of electric utilities) from the current law 12% to 14.6% beginning January 1, 2006. Section 5 increases the tax rate on class 13 property (telecommunication utilities and electric generating property of electric utilities) from the current law 6% to 7.3%. Although this would increase the taxable value for many local taxing jurisdictions, under 15-10-420, MCA, taxing jurisdictions may only increase revenue from the prior year equal to one-half the rate of inflation, plus any “newly taxable property” located in the jurisdiction. Increasing the tax rate on class 9 and class 13 property is not considered newly taxable property under 15-10-420, MCA. Therefore, mill levies in the affected jurisdictions should adjust downwards and no additional local property tax revenue would be generated as a result of sections 4 and 5 of the proposal. However, as a result of reduced mill levies in the affected taxing jurisdictions, property in other classes would see a reduction in their tax liabilities.

Repealing the 95 mills levied statewide for state government purposes will reduce the amount of revenue accruing to tax increment financing districts across the state by about $2.211 million, annually. This may impact some TIF districts’ ability to service their bonding obligations without other local government action.

Local property tax mill levies will be reduced by the number of mills that otherwise would be levied to support the BASE portion of school district general fund budgets under current law.

LONG-RANGE IMPACTS:
FY 2008 is the first year when the provisions of this bill would be fully in effect and there would be no effects of the transition.

In FY 2008, revenue to the sales tax account would be $419.871 million. Of this, $134.411 million is allocated for new expenditures, leaving $285.460 million for school equalization. Revenue to the general fund from property taxes, income tax, and the oil and gas tax would be reduced by $192.746 million. This would increase the general fund ending balance by $92.714 million.

Revenue to the university system 6 mill account would be reduced by $13.913 million.

The new expenditures, new revenue, and excess of new expenditures over new revenue from this bill would grow over time.

TECHNICAL NOTES:
1. Section 45 transfers money from the new sales tax account to the general fund for expenditures required by HB 124 and HB 200. This bill needs to have language that coordinates with those bills
2. Section 41 provides that a seller with a tax liability that averages less than $100 a month may report and pay the tax on a quarterly basis. However, the vendor allowance in Section 43 only refers to monthly filers.

3. Section 12 of the bill provides for a low-income credit against individual income taxes for sales taxes paid. Because the credit is tied to gross income, taxpayers and households with business and other losses that reduce their gross incomes below zero will not qualify for the credit.
4. The definition provided in Section 14(40) that includes computer software as "tangible" personal property is in conflict with the current definition in 15-6-218 (2)(a), MCA that defines computer software as "intangible".
5. Section 25 indicates the premiums of an insurance company are exempt. It might be better to state the premiums "paid to" an insurance company are exempt, since it is the purchaser's premiums that are exempt and not the insurance companies' premiums.
6. Sections 21, 38, and 39 provide for government agency exemptions for all products and services. Under current law, government agencies are subject to the rental vehicle and lodging facilities tax.
7. Under the amended language in Section 45, sales tax revenue collected is deposited in a special revenue account and is then moved into other accounts. There is no discussion of the process or timing of these allocations.
8. Section 45 amends 15-68-821. Subsection (2)(c) references the tax rate reduction in class eight business property under 15-1-111, MCA; the correct reference should be to 15-1-112, MCA.
9. Section 45(3)(g) allocates sales tax revenue "to the general fund to the credit of the department of revenue to offset the administration of Title 15, Chapter 68." Revenue allocated to the general fund can not be earmarked in this way. It needs to be appropriated either in HB 2 or in this bill.
10. Elimination of the 55-mill county equalization levy may reduce the eligibility of school districts for federal Impact Aid.
11. Section 2 (15-1-112, MCA) revises statutes related to local government reimbursements for business equipment rate reductions. On page 6, line 22, the bill strikes 1999 and replaces it with 2005. The proposal reads "*(a) The reimbursement amount for tax year ~~1999~~ 2005 and each subsequent tax year for 9 years must be progressively reduced each year by 10% of the reimbursement amount for tax year 1998*". In context of the reimbursements, the reference to 1999 should remain. Under this section, the reimbursement would continue for 9 years after 2005 reduced by 10% per year, but the schedules listed further on in the same section still have the reimbursements calculated to end following 2007.

DEDICATION OF REVENUE:

a) Are there persons or entities that benefit from this dedicated revenue that do not pay? (please explain)

No. Sales tax revenue would be collected from all segments of the state economy.

b) What special information or other advantages exist as a result of using a state special revenue fund that could not be obtained if the revenue were allocated to the general fund?

None.

c) Is the source of revenue relevant to current use of the funds and adequate to fund the program activity that is intended? Yes / No (if no, explain)

Yes.

d) Does the need for this state special revenue provision still exist? ___Yes _X_No (Explain)

This bill creates a new state special revenue fund for sales tax collections and transfers money from this fund to the general fund and other state special revenue funds for expenditure. There is no need for separate special revenue funds for collections and expenditures.

e) Does the dedicated revenue affect the legislature's ability to scrutinize budgets, control expenditures, or establish priorities for state spending? (Please Explain)

Yes. This bill creates several unnecessary transfers between funds which will artificially inflate measures of total state spending.

f) Does the dedicated revenue fulfill a continuing, legislatively recognized need? (Explain)

This bill would transfer funds to several existing state special revenue funds that are appropriated for legislatively authorized programs. The new sales tax special revenue fund it would create would be used solely to track collections and not for any legislatively recognized purpose.

g) How does the dedicated revenue provision result in accounting/auditing efficiencies or inefficiencies in your agency? (Please Explain. Also, if the program/activity were general funded, could you adequately account for the program/activity?)

This bill creates several unnecessary transfers between funds. It would be more efficient to allocate collections directly to the funds that expenditures will be made from. If there were a reason to deposit sales tax collections in a separate state special revenue fund, it would be more efficient to make expenditures directly from that fund.